Contract negotiation handbook

Getting the most out of commercial deals

DAMIAN WARD

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For Caroline, Miles and Toby

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Introduction

This book will help you get the most out of your commercial deals and contracts.

The commercial world can be a cold, hard place. There are hundreds of thousands of intelliger hungry and astute people doing deals every day in Australia. Very few of them are suckers. Most kno their business and what they want to get out of it on every level — profit, growth and expansion.

When you are in such a competitive environment it is critical that you are prepared. This book wi help you prepare for contract negotiations and to do the best possible deal you can.

As a lawyer who has been involved in negotiating many commercial contracts over the years, I hav seen a kaleidoscope of behaviour from the incredibly astute to the widely speculative.

Some of those who have negotiated best are those without any 'formal' education. Their insigh intuition and ability to manage the other parties has been educative to watch. At the other end of th spectrum have been those who have MBA or doctoral qualifications but proceeded through the de with clumsiness and a lack of smarts. This reinforced a maxim I was given by a client when I was junior lawyer: *What you know is important, but whether you win or lose today depends on how you u it.*

I have also assisted clients with my fair share of disputes over the years. What has ultimate compelled me to write this book is seeing too many people fall into traps that are easily avoided - concentrating on the sexier or more cosmetically important parts of the deal to the detriment of th 'stuff drafted by the lawyers for the lawyers', as one client once told me.

If some of the lessons in this book had been employed at the outset, millions of dollars could hav been saved and been better spent on business expansion and improving the bottom line rather than o lawyers in disputes neither party wanted to have.

In a slightly melancholy way, I suppose the other theme of this book is never to openly trust in th negotiation and performance of contracts. My view of contracts is that they are essentially competition where both parties are seeking to obtain the maximum advantage for themselves. Whi there may not be winners and losers as there are in a sporting contest, often one party comes o second best. A contract negotiation is not a place for a group hug or to blindly rely on the word of yo counterparties.

In my experience trust is directly related to leverage — he or she with most leverage can be th most trusting. However, there are not that many contracts that I've seen where the leverage is so on sided as to give the more powerful or stronger party the right to be complacent.

Bearing in mind the general parallel of competition will help. Just as the person marking you football or on the other side of the tennis court net is a competitor, so is your counterparty in negotiation.

It is important not to mistake or merge competition with enmity. The best contractual negotiation and ironically the best contracts as far as performance are concerned, tend to be between parties wh negotiate hard for the strongest deal for themselves and both sides mutually recognise this. It develop a sense of respect. That respect in turn is the basis for performance of the contract.

This book is targeted at all people who negotiate contracts, from a junior procurement officer small businessperson to a senior corporate executive.

From my observation, people at all levels in the commercial hierarchy can fall into similar types traps and create problems for themselves and their businesses that could be avoided by more focus an preparation.

It is critical that what they want and need out of the deal is clearly known.

This book is in essentially three parts. They are:

- *The contractual environment* — a user-friendly précis of the law and the legal elements of contract. I have placed an emphasis here on removing the jargon and unnecessary verbosi lawyers speak with in the hope of making what seem complex and strange ideas easily graspab concepts.
- *Doing the deal* — from the first stage or baby steps to the final negotiation of the contract. provide practical tips and assistance in this process.
- *The end of the relationship* — the third part of the book addresses termination. In particular deal with the situation where things end badly and a dispute arises.

The key word is preparation. I have often been surprised in the past by the confidence contra negotiators have had in doing a deal that meets all their needs and wants when in fact they a unprepared. They have not fully articulated those needs and wants to themselves — let alone been in position to negotiate the contract in a dynamic environment with a counterparty who wants as much they can get in their own best interests.

If there is one message I would like contract negotiators to take away from this book, it is that the is no limit to the amount of preparation you can do at every level for the negotiation. A bad negotiated contract is like a two-storey brick house built on a foundation of sand. It may look good f a period of time but the sand shifts and the walls collapse. A negotiation that has been properly ar completely prepared will generally see a house that lasts for as long as the owners want it to.

Given the competitive context of contractual negotiations, I cannot guarantee that after reading th book that you will necessarily have the upper hand in every negotiation and do deals that every tin meet your heart's desire. Sometimes the bitter truth is that you will need to do deals with people wh have more power, money and leverage. You are not in the position to get the deal you necessaril want.

However, if you still use the tips set out you will be on much stronger ground and are likely to hav negotiated a better position than might otherwise have been the case.

What this book is not

You will be unsurprised to know that, like any lawyer, I like to get my disclaimer in early!

This book is a general guide to negotiating contracts and the law of contract. It is not a textbook. contains a summary of often complex and arcane legal principles.

There is no substitute for getting specific legal advice. If you have an issue in relation to enterin into a contract or, alternatively, a dispute arising from the performance of one, talk to a lawyer who experienced in the field.

Like people, each contract is different. The nature of the issues you have in relation to the contra will depend on factors such as:

- the subject matter of the contract
- the amount of money under the contract
- who your counterparty is
- the respective resources the parties under the contract have
- the importance of the contract to the parties in their business

- the access either party has to legal advice
- the personalities involved.

As a matter of law, your lawyer has specific duties to you as a client. These duties are important an taken seriously by lawyers.

While I hope you can use this book as a general reference and as a guide to understanding th concepts and issues in relation to negotiation of contracts, it cannot replace tailored and precise leg advice!

Part I

The contractual environment

Chapter 1

Springboard and safety net

A good commercial contract has the characteristic of being both a springboard and a safety net. It both a sword and a shield. It provides an opportunity to expand and grow your business yet must hav within it protections so as to ensure that if things go wrong, your position is guarded and preserved the fullest extent possible.

Optimism is a good thing in a negotiation

There is a natural tendency in negotiating and then entering into a contract to believe that because your personal experience, skills and attributes, you will be able to negotiate a contract that watertight.

Rarely does the entrepreneurial businessperson believe there will be any problems under th contract. They think if there are, they will be able to fix them. While commercial braggadocio of th kind has probably got them where they are, I would also bet it's bought them more than a fe problems in their commercial lives. This is because in all likelihood they have seen the contract as springboard and ignored the safety net that should be incorporated in it.

Bear in mind both dimensions of the terms of a contract. Give them equal importance in both yo preparation and negotiation of the deal. If you make sure of this you will do your absolute best guarantee that all possible problems at both the front and back ends have been dealt with prior signing on the dotted line.

How the contract will give your business bounce

Obviously any person in the commercial world entering into a contract wants to obtain the be possible financial and commercial position for themselves. For a provider of a good or service the want to be able to charge the highest price the market will bear giving them the highest positiv profile and a platform to developing a longstanding and loyal relationship with their customer. Th purchaser in all likelihood would like to pay the lowest possible rate for a good or service of th highest calibre with an honourable counterparty who will work with them to ensure the contract giv them all the benefits they hope and desire from it.

In this context, both parties are looking to the best deal in their own interests. They want to enhan themselves in a commercial sense. The springboard component of a contract negotiation is the eas part. If you have undertaken proper preparation and you know your business environment, knowin what you want is relatively unchallenging.

It is the pessimistic and caution-driven safety net that provides more of a problem.

Sometimes even the most skilled of highwire artists slip!

Generally, the safety net is the part of the contract that allows you to address what will happen if the are problems in the relationship with your counterparty. If one party or the other does not perform th

contract, you will want to know what the implications will be.

As mentioned in the introduction, one of the big themes in this book is preparation. There is almo no limit to the amount of thinking and consideration you can give to:

- where you want to be during the course of the contract on a macro level
- precisely what you want to get out of the contract on a micro level
- what it will take for you to perform the contract
- what it will take for your counterparty to perform their parts of the contract
- the danger areas (or identifying what are) the potential issues that may arise during the course the contract
- assessing the possible permutations and combinations of problems and whether at any stage time a particular type of breach can be remedied by a patch or a fix
- what happens if your counterparty falls over and can't perform the contract at all — ho important is this contract to the continuation of your business?

The vices of not properly considering the safety net are illustrated by the example overleaf.

Example

Persuasive Advertising Agency is a medium-sized agency that prepares print media advertisements for clients. Virtual all its work is by computer. Advertisements are prepared on tailored software programs and almost all writt communication with clients is by way of email or other electronic means.

Given its size, and for other commercial reasons, Persuasive enters into a maintenance agreement over both software a hardware with Total Computer Maintenance Solutions. Total is a small enterprise that has five technicians. Three of tho technicians are owners of the business and the other two are employees. The significant appeal for Persuasive was th each of the Total representatives they met came across as professional and personable and that they guarantee hi levels of responsiveness. On this basis and just before entering into the maintenance agreement Persuasive retrenches two internal IT staff.

Soon after the contract with Persuasive, Total enters into a separate agreement with Mega Merchant Bank. It is for furth computer maintenance. It was an attractive offer and one they couldn't refuse.

In the interests of maximising profitability and with the hope of not sacrificing service, Total do not employ any furth technicians and retain the five staff in the business to provide client-related services. They think they can deal with bo clients with current resources.

On a deadline for a major blitz of pre-Christmas advertising for another client, a large department store chain, t Persuasive computer system crashes. Contact is made with the representatives from Total. Each of the five technicians working at the bank. No-one can be spared to assist Persuasive. This means that deadlines are missed for publishi print advertisements for the department store. This means Persuasive is in breach of its contract and loses the client the basis that it could not deliver what it said it could.

Persuasive's desire to enter into a contract based on price (the springboard) and optimistical believing that nothing will go wrong (and therefore the absence of a safety net) has led to catastrophic problem. There is no clear and easy solution for it. It may have rights for damages again Total for breach of the agreement; however, depending on how precise the performance measures ar in the agreement, this claim may be speculative and therefore problematic to assert. Either way, it wi mean time-consuming and potentially expensive court proceedings.

Working out the difference between springboard and safety net terms

The distinction between springboard and safety net terms is quite clear.

It is almost as simple as discerning the front end of the contract from the back end; that is, th entrepreneurial attractive part from the insulation against things going wrong.

The springboard terms will tend to be those that everyone wants to focus on. They will be the term like:

- What is the good or service to be delivered under the contract?
- When is the good or service to be delivered?
- How much is the provider of the good or service going to be paid?
- By what means are the goods or services to be delivered?
- When will the provider invoice for the goods or services?
- What are the terms of payment (such as 30 days after invoice)?
- Is there any exclusivity in the contract for providing the goods or services?
- Is the contract of limited or unlimited scope?

These are the interesting parts of the contract for both parties.

On the one hand for the provider of the good or service, these parts deal with the big issues like:

- What have I got to deliver?
- When do I have to deliver it?
- How much am I going to be paid?
- When am I going to be paid?

On the flip side, the issues for the purchaser will be:

- What am I going to get?
- When am I going to get it?
- What will it cost?
- When do I have to pay?
- How much of the product do I currently need?
- Is there scope for an uplift?

The safety net clauses will look immediately less interesting. That is because they tend to be more standard form and do not deal with the sexy parts of the contract — what you are getting or what yo are paying for it.

They will tend to deal with matters like:

- indemnities
- whether the agreement is an entire agreement or is a mix of different types of terms
- whether there are any warranties

- the variation provisions
- how the respective parties can terminate the contract and on what basis
- any agreed damages liability for one party to the other if the contract is breached
- what happens in the event the contract is rendered impossible to be performed by one party or t other
- how GST is to be dealt with.

These provisions look generally unappetising to read. They appear to have been drafted by a lawy who thinks the sky is about to fall on his or her head! They are, for want of a better term, the borir parts of the contract.

However, the importance of the relatively less glamorous part of the agreement should not b underestimated. These clauses are critical. They are as enforceable as any of the more immediate business focussed 'front-end' clauses in the contract. A failure to properly consider where your be interests lie and how the contract should pan out in practice may cause untold difficulties if there a problems in the contractual relationship.

So what does this mean?

A successfully negotiated contract should have attention paid to both the springboard and the safe net. It should not sacrifice one at the expense of the other.

As previously suggested, a key theme in this book is planning before you start talking. The mo you think about these issues, and in particular anticipating what might go wrong and what th implications of this will be for you, the better armed you will be in the negotiation to deal deftl quickly and efficiently with all issues.

Another advantage will be that, as often as not, your counterparty will not be focussed on the apparently more mundane and less interesting aspects of the contract. By having a greater awarene and understanding of all aspects of contracts you may be able to get the jump on the other party your advantage.

As suggested above, there is a natural tendency to focus on the front-end issues. This is at the enti expense of looking at the back end. This means a person who has given holistic consideration to th contract will be forearmed with views as to what is likely to happen to the contract and what the position will be if things go badly.

The two levels of the safety net

There are two broad levels of thought you should work on when considering your position ar negotiating the contract with regard to the safety net. They are:

1 What clauses do I need to include in the contract to ensure that my position is protected my counterparty breaches or does not perform their obligations under it?

2 What will be the implications for my business if this contracting party either is not willi to, or is unable to, perform their obligations under the contract?

The first of these has a more direct relationship to the precise terms and clauses of the agreement. Th types of safety net clauses set out above are internal mechanisms in the contract that can assist you maximise your position under it. In particular, warranties, indemnities and liquidated damages clause can be really important aspects in maximising your position.

The second level goes to the viability of the contract. If the contracting party with whom you hav entered into an agreement does not perform their obligations, do you have another supplier of th relevant good or service to step into their shoes at short notice so as to ensure minimum busine disruption?

This is more a general commercial risk management issue and is often difficult to cater for. Agai liquidated damages clauses and termination clauses drafted in the appropriate and precise ways ma be important.

Clauses like this will allow you firstly to exit the contract on the default and claim back any damag you have suffered that is agreed under the contract. Of course you have no legal necessity to agr what the damage will be and you have your rights at general law if there is a breach of the contra irrespective as to whether there is a damages clause in the contract or otherwise.

Later in the book there is a more precise outline of contractual terms and their effect.

Two sides of the coin

Two parties negotiating a contract tend to have different perspectives on what they will and will n do and what they want to get out of the deal.

At various times in this book the perspectives of a seller or a purchaser are adopted.

It is not intended as a manual for either sellers or purchasers. The premise is to set out gener principles and guidelines in relation to negotiating contracts for both sides of the deal.

Who can enter into a contract?

Generally speaking individuals, companies or other entities have absolute freedom to enter in contracts. Individuals, companies or other entities can enter into contracts that are good, bad indifferent. They may agree rights and obligations in those contracts that are commercially sensible self-evidently unwise.

There are certain categories of people who do not have freedom to enter into contracts. In broa terms they are:

- children
- people with a mental illness
- intoxicated or drunken people
- bankrupts or companies in liquidation.

The right to freely enter into a contract for these people or entities is impaired by virtue of the special difficulties derived from immaturity, compromised circumstances or practical hurdles.

Being a party to a contract — what does this mean?

Entering into a contract is serious business. It means earning certain legal rights on the one hand an committing to obligations on the other.

Example

You are a procurement manager for a public company that owns a coal mine. You acquire an expensive new draglin mechanism for the mine. You negotiate the terms and conditions of the contract over a significant period of time a satisfy all the requirements of who can enter into a contract. The contract is signed by both parties.

Your company now has a legal obligation to do for the other party what it said it would do. That woul generally mean providing information to them as necessary so as to perform their obligations. It wi most certainly mean making a payment or delivering goods or services to them at a milestone or date that is agreed. It may mean making a sequence of acts at different times during the course of th contract. Subject to all of the above elements being satisfied, you have an obligation that you cann simply abandon or avoid. The company cannot elect that it is no longer bound by the contract. Th only rights you will have to terminate the contract will be for breach by the other party or on som other basis that you have negotiated.

The old cliché that a contract is ‘not worth the paper it is written on’ is a brave and possibly unwis comment for a party to it to make. A well-drafted contract that can be enforced is invaluable. Yo ignore it at your peril and cost. If your counterparty is sufficiently aggrieved by your conduct in n satisfying your obligations to the letter and within the spirit of the agreement, it may be able terminate the contract and sue you for breach of it. This may have significant financial consequences

Entering into a contract is a commitment that, subject to various conditions being satisfied, is ver hard to break or ignore.

To do so will be to risk serious and decidedly undesirable consequences!

Chapter 2

Contracts — what are they?

Doing deals — the stuff of life

Contracts are the essential heart of any commercial relationship. We all enter literally hundreds o thousands of contracts over our lives, many of which are verbal. They are as important a part modern business life as walking, talking and breathing.

This book is primarily focused on negotiating commercial contracts. It does not deal with a 'retai contract where you seek to buy food from the supermarket or a movie ticket. In those types contracts there is little room for negotiation and there is a beautiful simplicity to the relationsh between you and the other party — you want what they have and are willing to pay for it (or vi versa). That's it!

While these essential dynamics are present in larger commercial contracts, the rights an obligations of the parties and the context in which the contract is negotiated is much mo sophisticated, subtle, and at times, treacherous.

This section will help you:

- understand what a contract is
- understand the consequences of breaching a contract
- negotiate a contract
- avoid pitfalls in negotiations
- better manage your contractual relationships.

Lawyers can be terrifically presumptuous in seeking to advise clients how to negotiate commerci deals at the business level. This is wrong. No-one knows your industry, and in particular yo business, as well as you. You are the one selling or buying the product, good or service. You are th one directly dealing with the representative of a company on the other side. You are in the middle o the fascinating, compelling and sometimes frustrating dynamic of trying to do a deal. You are be positioned to know what is a good deal and what is bad.

I have no ambition to try to tell you how to do that.

This is not least because negotiation styles are as varied as the individuals in the busine community. What works for one person does not work for another.

The negotiation soup

A successful negotiation is a mix of:

- leverage
- strategy and tactics
- personal relationships

- concessions — giving in what does not matter to you but does to them
- judgement and reading the play
- timing
- restraint
- presentation
- decisiveness
- theatrics — the spectrum of leaving a negotiation in a huff to poker-faced silent contemplation
- the ‘bottom line’ — the point at which an impasse may be reached and the parties do the deal or not.

Reading your counterparty, understanding their agendas, knowing their strengths and weaknesses an seeking to position them to your advantage is a subtle synthesis of all of these elements.

No matter what anyone says, there are no hard-and-fast rules of the game to apply.

Successful negotiators exist on intuition and wit as much as wisdom and intellect.

I have tried to provide you with some background information from a lawyer’s perspective tha when combined with your intuition, wisdom and intellect, will hopefully enhance your position in an commercial negotiation.

The contract tree

There are three broad stages in entering into a contract:

1 preparation and negotiation
2 agreement of core or ‘trunk’ terms
3 agreement of further terms — the ‘safety net’.

The contract tree pictured in figure 2.1 (overleaf) figuratively represents the three stages.

Figure 2.1: the contract tree